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THE NORTH AMERICAN FREE TRADE AGREEMENT

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INTRODUCTION

Trade negotiators from the United States, Mexico, and Canada initialed the North American Free Trade Agreement (NAFTA) on October 7, 1992. This event marked more than two years of intense negotiations which culminated in a 2000-page plan to reduce and ultimately eliminate most of the remaining trade and investment barriers between the three nations. Three days earlier, then-candidate Bill Clinton had finally endorsed the pact, much to the chagrin of many Democrats with important labor and environmental constituencies. While Clinton's embrace of NAFTA included a promise to protect US workers rights, jobs and the environment, this promise has not allayed the fears of congressional Democrats who are feeling strong pressures to force the new President to renegotiate the entire agreement.

Clinton's handling of the NAFTA issue will provide an important early test of his ability to shift from campaign rhetoric to policy formulation. At the heart of the matter is the fundamental debate between protectionism and free trade. While Clinton the campaigner bemoaned the loss of US manufacturing jobs to Mexico, as President he is forced to consider the long term national

security implications of the United States reneging on promises made to two of its three largest trading partners. And though Clinton most certainly does not want to ruffle the feathers of congressional Democrats so important to his ultimate success, he will be equally loathe to break another campaign pledge by reversing his decision not to renegotiate NAFTA. In this regard, NAFTA may prove to be the most explosive and significant economic issue Clinton will face in his first few months in office.

This paper will address the NAFTA issue by examining US, Mexican and Canadian goals regarding NAFTA, and discussing some of the more important policy controversies surrounding its implementation. It will conclude with recommendations for the new US administration to consider as it debates this important domestic and international economic issue.

THE NAFTA AGREEMENT

NAFTA is designed to create a free trade area between the US, Canada and Mexico. In accordance with General Agreement on Tariffs and Trade (GATT) rules, all tariffs will be eliminated within the free trade area over a

transition period lasting ten years. Some of NAFTA's more important provisions include an ambitious attempt to eliminate barriers to agricultural, manufacturing and services trade; to remove investment and capital flow restrictions; and to protect intellectual property rights. While the agreement certainly continues recent trends toward greater economic integration throughout North America, it also portends much larger and more fundamental changes in political and social relations, particularly between the US and Mexico.[1]

NAFTA will create the largest free trade area in the world -- 360 million consumers, and combined gross domestic production of $6 trillion. Moreover, as the first such agreement between industrialized nations and a developing one, NAFTA offers a unique opportunity for North America to gain a competitive edge over Japan and the European Community by combining the advanced technology and production resources of the US and Canada with Mexico's inexpensive labor.[2]

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[1] For a more detailed, but still concise, summary of NAFTA's particulars see US Department of State Dispatch, August 17, 1992, Vol. 3, No. 33, pp. 641-644.

[2] Robert A. Pastor, "Response," New Perspectives Quarterly, Spring 1991, p. 68.

THE PARTICIPANTS GOALS

The participants in the NAFTA process have different, but not incompatible goals. The US seeks several things, not the least of which is the further lowering of Mexican trade barriers to US products. Already the third largest market for US exports, many experts expect the Mexican market to be the world's fastest growing over the next decade. Another attractive feature of NAFTA for the US concerns the long and porous US-Mexican border. In this regard, an agreement that fosters economic prosperity and political stability in Mexico could only be beneficial to the US. Finally, if NAFTA proves a "win-win" deal for all participants, it would provide a model for expanding economic relations between the US and the rest of Latin America (and between the industrialized "North" and the developing "South" in general).

From the Canadian perspective, NAFTA is the vehicle for protecting and expanding the economic gains achieved through the bilateral US-Canadian Free Trade Agreement. Specifically, these include greater access to the US market, increased American foreign investment, and expanded trade in services. Moreover, Canadian businesses, like their US counterparts, seek duty-free access to the expanding Mexican market.

Mexico seeks through NAFTA to secure access to the vast US and Canadian consumer markets and to attract badly needed foreign capital. In this sense, the agreement is the crown jewel in President Salinas' long term policy of transforming the Mexican economy from the highly regulated, import substitution model of the early 1980s, to one that emphasizes modern, liberal, market friendly principles. Thus while critics have argued that NAFTA only formalizes changes that have already taken place, President Salinas recognizes the importance of the agreement as a means to consolidate gains made to date, thereby providing the "permanence" necessary to attract foreign technology and capital investment.[3]

KEY ISSUES

Surprisingly, given the intense public debate in the US regarding NAFTA's impacts, most experts who have analyzed the issue believe that the direct economic effects of NAFTA will be small for all three countries.[4] This is due to several factors. First, tariff and quota restrictions on trade between the three nations had already been reduced considerably, a trend that would have continued

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[3] Carlos Salinas de Gortari, Interview, NEW PERSPECTIVES QUARTERLY, Winter 1991, pp. 4-9.

[4] Various authors presenting papers at Brookings Institution NAFTA Conference, 9-10 April 1992 (as summarized in North American Free Trade, Brookings Institution, 1992).

even had there been no NAFTA agreement. Thus many of the changes associated publically with NAFTA have already occurred, or would have occurred anyway. Second, static economic analyses demonstrate that "international trade in manufactured products will be less affected by NAFTA-driven price changes than is commonly supposed." Third, the increase in US imports from Mexico will likely come at the expense of imports from other developing countries instead of at the expense of US production. Fourth, as the Mexican economy expands, US and Canadian imports to Mexico will increase accordingly, to an extent that US-Canadian employment and average wage increases will more than offset the negligible negative impact on specific low-wage workers. Finally, while the US and Canada will lose some low-wage, low-skilled jobs to Mexico, these positions would have shifted to other "cheap labor" locales had NAFTA not made it more attractive to send them to Mexico. [5]

Despite this evidence to the contrary, many influential American leaders in the Congress and organized labor continue to fear NAFTA's impact on US jobs. These concerns are best reflected in a 3 October 1992 letter to President-elect Clinton signed by 97 members of Congress:

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[5]Brookings, North American Free Trade, pp. 2-4, 9-11.

> We are writing to urge you not to endorse the NAFTA because of the adverse consequences for US working people, consumers and family farmers, and the serious exploitation of low-wage workers in Mexico ... We believe, Governor Clinton, that you could negotiate a much more equitable agreement.[6]

In addition to the specific focus on trade and jobs, NAFTA has raised three important noneconomic issues: the environment, the social agenda, and democracy and human rights. Environmentalists argue that NAFTA, by expanding economic growth in Mexico, will damage the environment. Their argument centers on Mexico's lax environmental enforcement standards, which will attract environmentally-unfriendly industries seeking to lower pollution abatement costs. Many point to the high levels of pollution along the US-Mexican border, driven by the rapid expansion of the **maquiladora**.

In response to these concerns, Robert Pastor presents evidence demonstrating an inverse relationship between the level of pollution and income -- as nations become richer, they can afford more stringent environmental controls. Thus, as Mexico's economy expands, environmental conditions within the country will improve, a response which Pastor shows is already in progress. Moreover, Pastor points out that the costs of complying with

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[6] "Warning Bells on NAFTA Sound for Clinton," Congressional Quarterly, November 28, 1992, p. 3711.

environmental safeguards are small compared with other determinants of location. Finally, Pastor argues that NAFTA will actually make the maquiladora less attractive, by removing the tariff-related locational advantage. Thus, NAFTA will actually reduce the strain on resources along the border.[7]

Regarding social issues such as labor and health standards, and occupational safety, American labor leaders argue that NAFTA will allow US and Canadian industries to divert investment and production resources to the Mexico market, where labor standards are much less taxing. However, Mexican labor standards, while too expensive to enforce across-the-board, are actually more stringent than those of the United States. Again it can be argued that NAFTA, by increasing Mexico's wealth, will provide the material means to improve the lot of the Mexican worker.[8]

In the area of human rights and democracy, many have argued that while President Salinas has liberalized the economy, Mexico remains plagued by one-party rule, electoral irregularities and human rights abuses. Clearly, while Salinas can point to several encouraging signs (local election victories by opposition parties and the creation of a National Human Rights Commission), much remains to be done. However, as

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[7] Robert A. Pastor, NAFTA as the Center of an Integration Process -- The Nontrade Issues, The Brookings Review, Winter 1993, pp. 41-42.

[8] Pastor, NAFTA, pp. 42-43.

Salinas himself has pointed out, NAFTA, unlike the European Community, is strictly an economic agreement, and is not the vehicle for addressing North American democratic reform.[9]

RECOMMENDATIONS

NAFTA presents an important early challenge to the Clinton administration. It involves a complex mix of economic, domestic political, and foreign policy concerns. In this light, Clinton's campaign strategy of endorsing US commitments to a free trade area with two of its most important trading allies, while assuaging Democratic and labor fears by pursuing separate jobs, workers' rights and environmental agreements, is a wise one. Thus, the administration should commit itself to keeping NAFTA on the Fast Track desired by Mexico and Canada, but extract as a price for that commitment a pledge to complete the separate agreements in the same time frame.

Regarding the democracy and human rights issues, Saliinas is right in asserting that NAFTA is not the proper forum. Throughout the world, developing nations (including the former communist states) are struggling to find the formula for converting backward or outmoded economies to liberalized, market-friendly ones. Many, initiating

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[9] Salinas, Interview, pp. 4-5.

economic reforms in tandem with new democratic processes, succumb to the dilemma that democracies do not well tolerate the pain required for economic transformation. Salinas understands that sustained economic progress demands political stability. He is not alone. James Madison wrote that "You must first enable the government to control the governed; and in the next place oblige it to control itself." Salinas should be allowed to move to the next place at his own pace. He has the right formula -- trade brings prosperity, and prosperity is the best guarantee of democracy. The Clinton administration should assist Salinas in every way, ensuring that our enthusiasm for democracy and human rights be tempered by an objective understanding that Mexico is on the right path.